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SUBJECT: AUTOMOTIVE MANUFACTURING IN NW RUSSIA - DOWN BUT NOT OUT

11. (SBU) Summary. The St. Petersburg region - "Russia's Detroit" - is home to the largest concentration of foreign car manufacturing plants in Russia. These plants have suffered substantially from the economic crisis, and have significantly cut their production in recent months in the wake of a sharp reduction in demand. The Russian government's support measures for the car-making industry have so far been of little assistance, and in the short run the situation looks bleak. Nevertheless, the manufacturers generally remain optimistic about the long range outlook for the Russian car market. End Summary.

12. (SBU) St. Petersburg and Leningrad oblast have during the past eight years become the leading car-producing regions in Russia. Development of the auto cluster began in 2002, when Ford opened its assembly plant in the town of Vsevolozhsk in Lenoblast. Currently, the oblast and the city account for 7% of Russia's total automobile production, and for about 20% of the foreign-branded cars. Last year, Ford assembled sixty-five thousand cars, GM forty one thousand, and Toyota six thousand. Nissan plans to open a new facility in St. Petersburg in June this year with a yearly expected production capacity of fifty thousand cars. In 2008, both Suzuki and Hyundai signed agreements with the St. Petersburg city government to construct their own plants in the city, which will have the annual capacity to produce fifty thousand and one hundred thousand cars, respectively.

13. (SBU) However, the car-making industry in Russia has been hard hit by a sharp decline in demand due to the global financial and economic crisis. During the first quarter of 2009, sales of new cars in the Russian market fell by 47 percent compared to the same period last year, and experts fear a further market contraction for the rest of the year. The severity of the situation has prompted the Russian government to enact several measures aimed at avoiding the collapse of the country's car-making industry. One of the most important of these measures has been the 30-percent increase in customs duties on imported cars, which put imported cars at a considerable price disadvantage vis-a-vis those manufactured in Russia. American cars assembled in Russia fall within the category of domestic production.

14. (SBU) The federal government has also set up a new program which subsidizes the interest rates for the buyers of Russian-produced cars that are priced under RUR350,000 (about \$10,000). Though this program is technically impartial, in practice it substantially benefits only the native Russian car industry, as virtually all foreign-brand cars produced in Russia are more expensive. For example, amongst all the St. Petersburg-based car-assemblers, only Ford produces a car model inexpensive enough to benefit from the government subsidized interest rate program.

15. (SBU) So far, the government's support measures for the automobile industry seem to have been of little help for the foreign auto makers in St. Petersburg, who continue to experience declining demand and factory shutdowns. Declining demand forced GM to suspend production at its new plant just a month and a half after its opening in early November 2008. After several weeks of standstill, the plant resumed operations with just one shift working three days a week. However, the GM plant again suspended even these reduced operations for two

weeks in early April. Toyota has announced plans to suspend production at its plant in St. Petersburg for the first week of May, which will be Toyota's third production halt since the beginning of the year. Ford halted production for a month in January, and it plans to reduce its operating schedule down to four days a week beginning June 1. Nissan, which had planned to open its new plant in St. Petersburg in early 2009, has postponed the opening until June, even though the plant itself has already been fully constructed.

¶6. (SBU) Another factor that has hurt the competitiveness of foreign car manufacturers in Russia compared with wholly Russian-made cars has been the recent devaluation of the ruble. Because these manufacturers use predominantly imported parts, their costs in rubles have gone up significantly and they have had to pass those increased costs on to the Russian consumer. For example, the ruble sticker price for cars assembled at Ford's plant in Lenoblast have gone up nearly ten percent after two price increases earlier this year. And, Ford has announced a further nine-percent increase that will take effect in May. GM, for its part, has increased prices for its Chevrolet Lacetti and Opel models by about six percent since January.

¶7. (SBU) Comment. The car manufacturers in the St. Petersburg region are definitely feeling the bite of the economic crisis despite the federal government's efforts to support the industry. Despite their current difficulties, none of the manufacturers has cancelled its future plans nor downgraded Russia as a potentially lucrative future market for their automobiles. Thus, when the crisis ends, the manufacturers will be in a good position to quickly ramp up production to meet the inevitably increased demand for their autos. As one young Russian told the Consul General "once you've driven an American car, you never go back." End Comment.

GWALTNEY